

MULTI-STATE LOTTERY ASSOCIATION

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The California Performance Review
c/o Office of Governor Arnold Schwarzenegger
State Capitol
Sacramento, CA 95814

Congratulations to the CPR Team on the issuance of the California Performance Review report. The team covered a broad variety of specialized areas and we can appreciate the enormous scope of the work you were called upon to perform.

We do have some comments on the specific mandated criteria for selecting a multi-state lottery:

When choosing which multi-state lottery to join, the California Lottery Commission should consider the days and times on which the draws occur to minimize conflicts with the California Lottery, the size of its jackpots, administration and start up costs and the participation of adjoining states.

-- CPR Recommendations, Chapter 1, GG05

Powerball is the Best Decision for Higher Net Revenue

Speaking from long experience in the U.S. lottery industry, the lottery directors involved with this association agree with your conclusion that adding a multi-state game to the California Lottery will bring in more net revenue for the lottery. It will also act to expand the player base, making the California Lottery a part of life for a broader demographic mix of Californians.

However, when choosing which multi-state lottery game to join, we believe that the California Lottery Commission should not be mandated to focus on “draw days” or “adjoining states”. Instead, the lottery should consider the highest net revenue for the state. The lottery should also consider a proven brand with a long history of success that players will continue to enjoy and that will bring more revenue to the state for years to come.

Arizona Lottery ♦ California Lottery ♦ Colorado Lottery ♦ Connecticut Lottery Corporation ♦ D.C. Lottery and Charitable Games Control Board
Delaware State Lottery ♦ Hoosier Lottery ♦ Idaho Lottery ♦ Iowa Lottery Authority ♦ Kansas Lottery ♦ Kentucky Lottery Corporation
Louisiana Lottery Corporation ♦ Maine State Lottery ♦ Minnesota State Lottery ♦ Missouri Lottery ♦ Montana Lottery ♦ Nebraska Lottery
New Hampshire Lottery ♦ New Mexico Lottery Authority ♦ North Dakota Lottery ♦ Oregon Lottery ♦ Pennsylvania Lottery ♦ Rhode Island Lottery
South Carolina Education Lottery ♦ South Dakota Lottery ♦ Tennessee Education Lottery Corporation ♦ Vermont Lottery
United States Virgin Islands Lottery ♦ West Virginia Lottery ♦ Wisconsin Lottery

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Either multi-state game will bring in more dollars for California and so either choice can be deemed a "success" but a decision for Powerball will bring even more dollars to California. While we obviously have a viewpoint, we have also spent 15 years evaluating lottery options and have a proven record of conservatively estimating lottery game performance. When making any serious financial decision, it is best to consider past performance. If we assume that the California Lottery will sell at an average per capita rate in both games, we find that last fiscal year, the lottery would have sold \$666,044,198 with the Mega Millions game and \$1,009,744,274 with Powerball. Powerball is the clear winner.

Comparison of the Last Fiscal Year Gives an Extra \$340 Million to California with Powerball

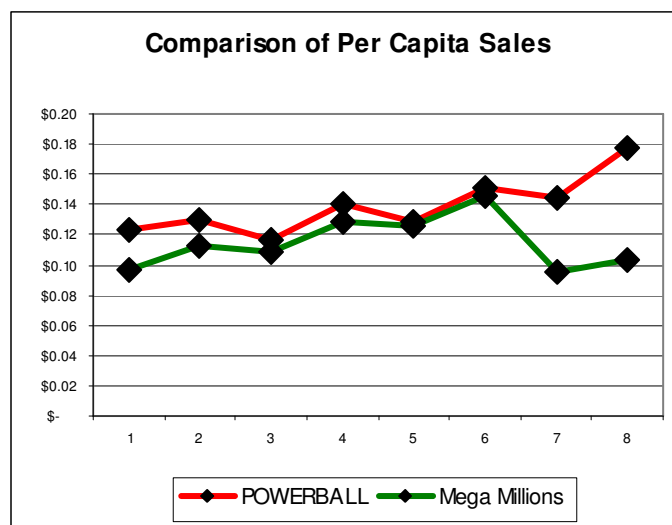
The Lottery will succeed with either multi-state game but the California Lottery should not have to leave \$343.7 million on the table (based on last year's sales comparisons).

Important Patent Rights Agreement

Last week, the Multi-State Lottery Association (MUSL) and Scientific Games (SGI) announced an agreement giving MUSL exclusive rights to sub-license a patent on the multiplier add-on game (sold as Power Play) for multi-state games. SGI will continue to be able to license the patent to their customers. This agreement means that Powerball is the only multi-state game that will be able to run the multiplier feature for all of its members. Of course, if the California Lottery joins Powerball, this important revenue source will be licensed to California by MUSL. Power Play makes Powerball a \$2 game for many players. For that extra dollar, a player who wins a Powerball prize (except the jackpot) will have their prize multiplied by a number we randomly draw from 2 to 5. The lotteries that begin Powerball with the Power Play feature have added another 20% to 30% to their base Powerball sales.

An Unfair Comparison – with a Revealing Insight

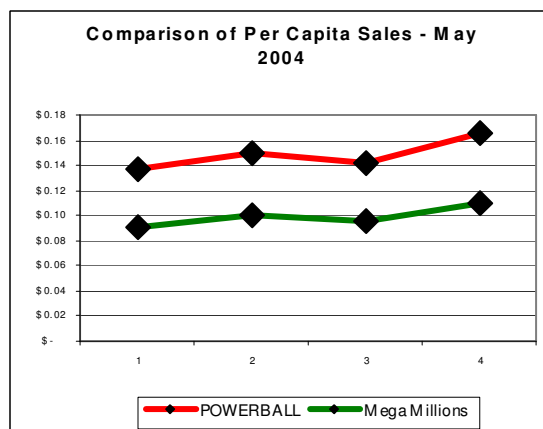
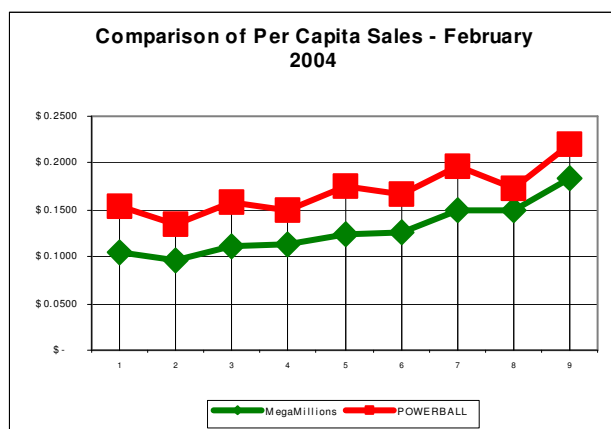
Like most industries, the lottery business is not as simple as it might seem. This chart, showing the comparative performance for eight recent draws, tells an important tale. The Mega Millions game (in green) had just come off an exceptionally large jackpot. Since interest in the lottery is high and since players are cashing in their winnings, the run following a large jackpot always gets a great kick start and usually becomes one of the game's best runs. To make this comparison even less fair, the



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Powerball game was hit at the second draw and so had a jackpot that was smaller than the Mega Millions jackpot for this comparison. Still, even with the added jumpstart of an exceptional ending jackpot and higher Mega Millions jackpots for this run comparison (until the seventh draw, when Mega Millions was hit and started over at \$10 million), Powerball still outsold Mega Millions on a per capita basis - and Powerball's extra Power Play sales are not included here. Even in this "unfair" comparison, Powerball is the winning choice. You can clearly see the power of the Powerball brand and game design.

On some occasions, we can compare the two games on a fair basis – that is, a comparison at the same time of year, draw for draw, jackpot for jackpot. The charts below show two recent per capita comparisons in February and May of 2004 – at the same jackpot levels. Powerball will bring in more dollars for California than will Mega Millions.



We do expect that both games would be changed with the addition of California's population but, again, we believe that past performance is the most prudent way to evaluate any serious financial decision. MUSL stands by its more than 15 years of success.

Cannibalization is the Same for Both Games – Regardless of Draw Days

The mandated game selection criteria identifies "draw days" as an issue. The draw day concern relates, in part, to cannibalization of in-state lotto games. Of course, California needs to consider cannibalization. Every lottery that joins a multi-state game has reviewed this issue and every lottery in the Powerball game knows that they made the right choice. The fact is that both games, regardless of draw day, can be expected to cause a 25% to 30% drop in sales for the in-state game. Both games will more than make up that difference, with Powerball skyrocketing higher in net sales.

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Cannibalization is also an area where simple data can be deceiving. If a particular lottery saw cannibalization different than 25% to 30%, there is a reason for it. It is important to learn the "hidden" facts behind each case. For example, the CPR Team was told that the Georgia Lottery, a Mega Millions state, experienced only an 18% cannibalization rate. What the report does not mention, however, is that Georgia was in the Powerball game and had already experienced cannibalization for its in-state game. The 18% drop that occurred when draw days were changed with the Big Game (Mega Million's previous name) was an *additional* cannibalization rate. This additional loss supports the view that many players who bought in-state game tickets were drawn to the retailer to buy in-state lotto tickets because Powerball was sold on the same day. Players have learned to play the big jackpot games on Wednesdays and Saturdays. Lottery tickets are often an impulse purchase and getting players to the retailer is the challenge. Players who are drawn to a big jackpot - whether in a multi-state game or in the in-state game - will also play other lottery games. Once a player is in the store and at the lotto counter, they will improve their chances of winning some prize by playing multiple games.

•New York had 30.6% drop in lotto sales, but sales were up 15% overall.

(Lottery Director, New York Times, April 3, 2003 - Mega Millions)

•Washington State had 30% drop in lotto

(Lottery budget director, Jan 2003 PGRI Presentation - Mega Millions)

•Vermont had 25% drop in lotto but sales were up 22% overall.

(Lottery Director, December 24, 2003 - Powerball)

•Maine Expects 17% drop in Megabucks, but sees no drop so far.

(Lottery Director, August 3, 2004, Bangor Daily News - Powerball)

When you examine the facts for each lottery adding a multi-state game, you will find that the best guess for cannibalization is 25% to 30%, regardless of draw days. Draw days are not a factor in deciding upon a multi-state game, except that there is some evidence that a multi-state game should be run on the same days as an in-state jackpot game.

Jackpot Size - What Really Counts - Planning for the Future

The Mega Millions game currently holds the record for the largest jackpot in the U.S. at \$363 million split between two winners. Powerball's largest jackpot has been \$315 million to one winner. Jackpots do drive sales in multi-state games, however, the most important jackpot number to consider is the average jackpot size offered to the players. Powerball is again the winner. For the last two fiscal years, both games were operating with their current matrix and offered these average jackpots.

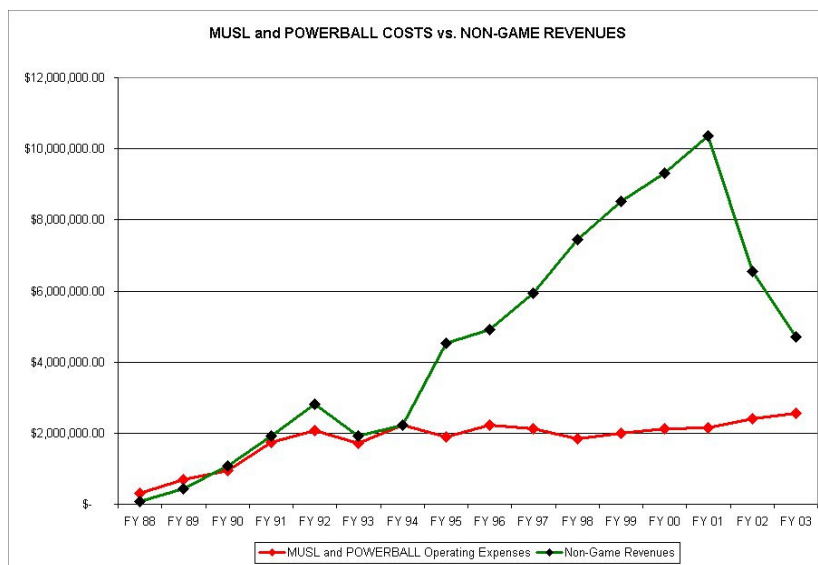
	Powerball	Mega Millions	
FY03	\$48,836,538	\$42,250,000	104 draws
FY04	\$61,590,476	\$52,847,619	105 draws

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There are more issues to consider when reviewing jackpots. Beside the size of a jackpot and the size of the average jackpot offered, players respond to jackpot rates of growth and perceptions of "record jackpots". Powerball has a plan in place to control jackpot growth. The press tends to focus on a record jackpot and a sudden rise to a new record amount can actually mean a loss of the opportunity to get press on the in-between record levels. At these astronomical jackpot levels, when a new record amount is reached, Powerball actually limits jackpot growth to \$25 million per draw. The money that would have gone to the jackpot is, instead, pushed down to the second prize level. When there is eventually a jackpot winner, it is also likely that up to a hundred players, or more, will also receive a second prize of \$1 million in cash. This Powerball-only feature, called the Match 5 Bonus Prize, will promote press coverage in every state with \$1 million winners and will also respond to complaints from players that the jackpots are too large and should be split among more winners. Powerball's approach to jackpots includes a responsible and planned approach to jackpot record growth to ensure a game that will remain successful for the long term.

Cost of Administration

Cost of administration is another one of the required criteria in choosing a game - though revenue will certainly take a much larger role. For the Powerball members, having a central office helps to keep state lottery employees available to continue their current duties; keeping this "hidden" cost of administration low for Powerball. The central office also works to find ways to earn non-game revenue that more than offsets the cost of operating the central office. Since year three of its operations, the Powerball members have seen their shared operating costs (the red line) more than covered by the central offices' non-game earnings (the green line). Of course, this excess is returned to the states.



This non-game revenue comes from interest earnings, bond swap profits, and trademark royalty fees. The association continues to find new ways to earn even more money for the lotteries.

When considering the costs of administration, it is important for the California Lottery to understand that it will send no money to the association to operate the Powerball game.

The Adjoining States Issue

Another one of the CPR's mandated criteria to be used in make the selection of a multi-state game is the "participation of adjoining states". Powerball is indeed a successful game that is available across the nation. One can drive from the Pacific to the Atlantic and from Canada to Mexico across the United States and never leave a Powerball state.



However, there is no merit in rejecting a game because it has been “too successful”. Powerball members learned years ago, that adding new members makes the game stronger for all. The proven growth record for all members, along with the concentration of California's population in the west, shows that adjoining states should not be a valid criteria for the selection of a multi-state game. California can continue to enjoy sales across the Nevada border, but it is the core sales within California that will prove to be the success of the game. The California Lottery must focus on offering games for its own population.

The broad reach of Powerball helps maintain the national interest in the game and gives Powerball a "border advantage". When the press picks up stories of a big jackpot, nearly everyone in the United States is either in or close to a Powerball state. This kind of national attention means higher jackpots and higher sales.

Powerball drawings cover 45 of the top 100 TV markets and 20 of the top 50 TV markets. Mega Millions has 31 of the Top 100 TV Markets and 16 of the Top 50 TV Markets.

Powerball Offers More Winners & Prizes for California

Another important factor for long-term game success is the number of prizes won by the players. Powerball's game design includes the important decision to bar-bell the prizes to pay more dollars out at the lowest prize levels where the most winners are, while still keeping the jackpot high. This is a proven design that attracts players to the game and then keeps them interested enough to continue playing. Looking at last year alone, California would have had 15,584,899 winners being paid \$121,943,107 in the Mega Millions game. In Powerball, California would have seen 23,332,381 winners (an additional 7.7 million winners) receiving a total of \$145,832,997 (an additional \$23.9 million in prizes paid to California players). This does not even include the *additional* \$81 million paid to California winners through the Power Play option - an option that can only be used in California with Powerball and the patent sub-license agreement.

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Seeing the Overall Revenue Picture

Adjacent states and draw days are false issues that should not be allowed to hide the true issue: how to increase revenue for the state lottery. Powerball offers more revenue, higher average jackpots, and higher average prizes paid to California players, all due to higher average per capita sales with no difference in cannibalization.

We are certain that Powerball is the best choice for California and welcome the opportunity to respond to questions or requests for even more detailed analysis of past performance or any given future promise of performance. We know that this is a serious decision for California and we hope that you will feel free to make use of our long experience in the lottery industry.

Please feel free to contact me if you have additional questions about MUSL or Powerball.

Sincerely,



Charles Strutt
Executive Director

cc: California Lottery
The California Performance Review